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Nos. 86-1772 and 86-1922

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1987

UNITED PACIFIC INSURANCE COMPANY, PETITIONER

v.

LAUREL COUNTY, ET AL.

LAUREL COUNTY AND LAUREL COUNTY FISCAL COURT,
CROSS-PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Laurel County, respondent in No. 86-1772, contends as cross-petitioner in No. 86-1922 that the district court erred in dismissing its third-party complaint against the United States.

1. In 1969, Y & S Construction Co. (Y & S) contracted with Laurel County for the construction of a high school building to be built in London, Kentucky. At the time the construction contract was signed, Y & S, as principal, and United Pacific Insurance Company (United), as surety, executed a performance bond in the amount of the contract price, as well as a labor and material payment bond in the same amount. Pet. App. A3.

Following Y & S's failure to submit withholding taxes on behalf of its employees, the IRS filed a notice of tax lien against Y & S on February 4, 1970, in the amount of $185,031. On March 11, 1970, a second notice of tax lien was filed by the IRS against Y & S in the amount of $162,719. On or before March 4, 1970, Y & S defaulted on the contract at a time when construction was about 75% complete. United then sent a letter to Leon Browning, the architect representing Laurel County, asking that no further contract funds be paid to Y & S or to anyone else without United's written consent. On March 15, 1970, Y & S sent letters to the Laurel County Fiscal Court and to Browning requesting that all funds due or about to be due on the contract be paid to United. Pet. App. A3.

On April 17, 1970, architect Browning certified that a contract payment was due and payable to Y & S in the amount of $116,667. On or about May 15, 1970, United made demand on the Laurel County Fiscal Court for all sums coming due under the contract. On or about May 18, 1970, the IRS served a notice of levy on the Laurel County Fiscal Court for delinquent taxes due and owing by Y & S in the amount of $100,834. Pet. App. A3-A4.

On the day the IRS levy was served, the Laurel County Fiscal Court honored it by paying the sum of $100,834 to the IRS. This amount was paid out of the School Construction Fund by a check endorsed by the County Treasurer. Prior to paying over the funds, the Treasurer had consulted two local attorneys, who advised that there might be personal liability if the levy were not honored. The Treasurer had earlier been authorized by resolution and order of the Laurel County Fiscal Court to make disbursements out of the construction fund upon certification by Browning that the said funds were due and owing. Pet. App. A4.

The Treasurer advised United of the payment to the IRS in a letter dated May 18, 1970, the day the levy was honored. Petitioner promptly protested the same. Ultimately, of the total contract price of $2,554,532, Y & S received $1,587,995; United, which completed the contract after Y & S defaulted, received $865,703; and the IRS received $100,834. Pet. App. A4.

2. United brought this suit in 1974 in the United States District Court for the Eastern District of Kentucky as a breach of contract action against Laurel County for the amount paid to the IRS. Laurel County filed a third-party complaint against the United States for indemnity and reimbursement. The district court dismissed the third-party complaint, holding that Laurel County had not complied with the nine-month limitations period for bringing actions against the United States for allegedly wrongful levies. See 26 U.S.C. 7426, 6532(c)(1); Pet. App. A4-A5.[1]

The district court next held, as a matter of Kentucky law, that the funds due under the contract had not yet become the "property" of Y & S when Laurel County paid a portion of those funds to the IRS. Because the IRS may validly

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[1] Section 7426 of the Internal Revenue Code (26 U.S.C.) provides that a third party claiming an interest in property seized for another's taxes may bring a "wrongful levy" action against the United States to have the property (or the proceeds of its sale) returned. Section 6343(b) of the Code provides that an aggrieved claimant may file, before proceeding to court, an administrative request for the return of the property. See Treas. Reg. § 301.6343-1(b)(2). United, which sat on its rights from 1970 to 1974, did not invoke either of these remedies. And, as noted in the text, the district court held that the third-party complaint could not be treated as a valid wrongful levy suit by Laurel County against the United States, since the statute of limitations on such suits is "9 months from the date of the levy" (26 U.S.C. 6532(c)(1)), and since four years had elapsed between the allegedly wrongful levy and Laurel County's filing of its third-party complaint. We are lodging with the Court 10 copies of the district court's opinion on this issue, which is not reproduced in the appendices to either the petition or the cross-petition.

levy only on "property and rights to property * * * belonging to" the taxpayer (26 U.S.C. 6331(a)), the court held that the funds were not available to satisfy Y & S's tax liabilities and hence should have been paid to United, rather than to the IRS. The court noted that 26 U.S.C. 6332(d), which discharges a custodian honoring a levy from liability "to the delinquent taxpayer," does not by its terms relieve the custodian of liability to a third party who is the true owner of the funds (Pet. App. A28). Accordingly, the court entered judgment for United against Laurel County in the amount of $100,834, plus interest.

The court of appeals reversed in part, affirmed in part, and remanded for further proceedings (Pet. App. A1-A19). It first held that the district court had erred, as a matter of Kentucky law, in ruling that Y & S did not possess any "property or rights to property" in the contract payments that could properly have been the subject of an IRS levy. Accordingly, the court concluded that Laurel County could properly have used a portion of the contract funds to satisfy a levy predicated on Y & S's unpaid tax liabilities. However, because the record did not contain a copy of the actual notice of levy (see *id.* at A4 n.2), and because the district court had not made a specific finding concerning its existence, the court of appeals remanded the case to the district court for further findings regarding the existence of a levy (*id.* at A5-A13).

As an alternative ground for its decision, the court of appeals held that federal law in any event would protect Laurel County from liability to United for erroneous payment in response to an IRS levy (Pet. App. A13-A17). Relying in party on this Court's decision in *United States* v. *National Bank of Commerce*, 472 U.S. 713 (1985), the court of appeals concluded that "where, as alleged here, the custodian of a taxpayer's property or rights to property has at the time of levy no defense for failure to comply

with the levy * * * and thus honors a lawful IRS levy, the custodian has a valid and complete defense under federal law to claims of third parties with interests in the property surrendered" (Pet. App. A16-A17). Thus, the court held that Laurel County will have a valid federal defense to United's suit if the existence of the levy is proven on remand.

Finally, the court of appeals affirmed the district court's judgment dismissing Laurel County's third-party complaint against the United States (Pet. App. A17-A21). The court explained that the third-party complaint was in substance a wrongful levy suit, which was time-barred, and that there was no basis for an interpleader proceeding (*id.* at A18-A19, A21).

3. United, in No. 86-1772, challenges the court of appeals' holding that, if it is determined on remand that a valid IRS levy was made on the contract funds, United's breach of contract action against Laurel County must fail. Because the United States was not a party to this dispute in the district court or to Laurel County's appeal on this issue in the court of appeals, we will not address this contention here in any detail. As we explained in our brief as amicus curiae below, however, we believe that the district court's judgment on this point warranted reversal. Moreover, apart from the correctness of the decision below, this case is clearly inappropriate for Supreme Court review. The case has been remanded to the district court for an additional factual inquiry, and United will prevail unless Laurel County can prove the existence of the levy. In that event, United will no longer have any interest in further review of the questions presented here. Therefore, the questions presented in the petition are not yet ripe for consideration by this Court. See, *e.g.*, *Brotherhood of Locomotive Firemen & Enginemen* v. *Bangor & Aroostook R. R.*, 389 U.S. 327, 328 (1967). In any event, the decision below, although it contains an alternative

holding based on federal law, rests independently on a construction of Kentucky law that obviously presents no question warranting this Court's attention.

4. Because Laurel County's protective cross-petition in No. 86-1922 is expressly conditioned upon the granting of certiorari in No. 86-1772 (see Cross-Pet. 8), the cross-petition should be denied if the petition in No. 86-1772 is denied. In any event, Laurel County's contention (Cross-Pet. 5-8) that the district court erred in dismissing its third-party complaint was correctly rejected by the court of appeals. Laurel County does not dispute that its complaint was time-barred if viewed as a wrongful levy action under 26 U.S.C. 7426. Rather, it claims that its third-party complaint should be treated as an interpleader action under 28 U.S.C. 2410(a)(5), a contention that was not made to the district court. This contention is without merit.

As the court of appeals explained (Pet. App. A18), an interpleader action was not available to Laurel County once it had disbursed the disputed funds in satisfaction of the levy. In the Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 201, 80 Stat. 1147, Congress extended the existing waiver of sovereign immunity, which covered suits to quiet title or suits to foreclose a lien in which the United States claimed an interest, to the analogous situations of condemnation, partition, and suits in the nature of interpleader. Congress explained that "[i]nterpleader actions are those brought *by persons holding property* for the purpose of determining who is entitled to the property held." S. Rep. 1708, 89th Cong., 2d Sess. 33 (1966) (emphasis added). Thus, the waiver of sovereign immunity in 28 U.S.C. 2410(a)(5) is restricted to situations where the suit is brought by the stakeholder of disputed property. It does not extend to a suit to recover property now in possession of the government simply because the plaintiff was once in the position of stakeholder.

It is therefore respectfully submitted that both the petition and the cross-petition for a writ of certiorari should be denied.

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Solicitor General

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